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Financial  
Condition

A REPORT

TO

HON. EMERSON C. HARRINGTON

COMPTROLLER OF THE TREASURY

CONCERNING

THE FINANCIAL CONDITION

OF THE

STATE OF MARYLAND

AND ALSO CONCERNING

A PROPOSED "STATE BUDGET"

DECEMBER 15, 1915

Submitted by Mr. Harrington to the Commission on Economy and Efficiency  
in the State of Maryland, December 18, 1915

HARVEY S. CHASE & COMPANY  
Certified Public Accountants  
84 State Street, Boston

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BALTIMORE, Md., December 15, 1915.

*Hon. Emerson C. Harrington, Governor-Elect,  
Comptroller of the State of Maryland,  
Annapolis, Maryland.*

DEAR SIR:

In accordance with your instructions I have made a careful investigation of the financial condition of the Treasury of the State of Maryland as it stood at the close of the fiscal year September 30, 1915.

I have also investigated the financial transactions covering income and outgo during the fiscal year which ended on that date. I submit herewith two Exhibits—I and II. The first is a statement of the cash in the Treasury on September 30, 1915, contrasted with the liabilities and obligations against this cash, as shown by the accounts of the Treasury on that date. The second sets forth the income and the outgo of the fiscal year, classified in such a manner as to separate the transactions in the Loan Funds and the Special Funds (frequently called the "Dedicated Funds") from those of the General Funds, i. e., funds available for any general purpose.

THE PRESENT DEFICIT.

It is evident from these exhibits that the financial condition of the State of Maryland is exceedingly serious. Liabilities and obligations against the cash balances in the Treasury and the banks on September 30, 1915, were in excess of these cash balances by \$1,446,555.81. This means that there is a deficit in the Treasury which at the end of the last fiscal year (September 30, 1915) amounted to this sum, and which, if the deficiency during the current year (1915-16) is as large as that of the past year (1914-15), will approach *two million dollars* by September 30, 1916.

## EXHIBIT I.

A STATEMENT OF THE DEFICIENCY OF CASH IN THE STATE TREASURY  
(EXCESS OF OBLIGATIONS) ON SEPTEMBER 30, 1915.

TOTAL CASH IN BANKS AND TREASURY.....	\$1,603,285.31
Deduct Cash due to Sinking Funds.....	756,384.35
Remainder of Cash.....	<u>\$846,900.96</u>

## Due to "Dedicated" Funds:

Public School Tax Fund.....	\$819,236.20
Road Repair Fund (Proceeds of Special Tax).....	51,342.35
Motor Vehicle Licenses Fund.....	33,356.89
Loan Funds (Proceeds of Bonds).....	32,936.02
State Accident Fund.....	32,081.06
Fund for Indigent Blind.....	14,375.00
Tobacco Warehouse Fund.....	13,192.88
Oyster Fund.....	8,983.27
Maryland Agricultural College Loan Tax.....	8,474.85
Common Free School Fund.....	3,572.50
Preservation of Natural Oyster Bars Fund.....	486.53
Special Roads Fund.....	486.52
Counties Funds.....	245.00

Total.....	<u>1,018,769.07</u>
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Deficiency of Cash (to meet "Dedicated" Funds).....	<u>\$171,868.11</u>
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*Additional Deficiencies.\**

Unpaid Balances of Appropriations for State and private hospitals, institutions, universities and other purposes, as follows:

Balances due to State hospitals and Training Schools.....	\$221,500.00
Private hospitals, homes, etc.....	327,725.00
Universities, schools, etc.....	287,243.00
Reform schools, etc.....	75,250.00
State departments, offices, etc.....	<u>362,969.70</u>

Total Balances carried forward to the New Year (not paid).....	<u>\$1,274,687.70</u>
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Total Deficiency of Cash in comparison with Liabilities and Obligations.....	<u>\$1,446,555.81</u>
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\*The unpaid balances of appropriations are exhibited in detail on schedules 1, 2, 3, 4 and 5 submitted separately.

## WHAT HAS CAUSED THE DEFICIENCY?

The first question concerning this deficiency which should be answered is: "What has caused it?" The reply must be

that the cause has been in evidence for many years. As long ago as 1907 the State Comptroller's report said: "A radical departure should be made by the Legislature in making appropriations. \* \* \* All standing, special, or continuous appropriations should be repealed, so that the merits of every branch of the State's service could be passed upon by each Legislature. There should be *one appropriation bill* for each year, which should carry every dollar of demands upon the Treasury for that period. If all appropriations were covered in one bill for each year with unexpended balances reverting, as the revenues of the State are easily ascertainable, the *budget* could and should always be made upon this basis." Meaning that the total appropriations should be confined within the total available revenue.

The Comptroller's report for September 30, 1914, said: "We are confronted with the very serious condition of our revenues not being sufficient for our necessities," and further: "In my judgment, the time has now arrived in the financial affairs of this State where a different mode or system ought to be inaugurated in dealing with appropriations. The present method is antiquated and unbusinesslike and woefully lacking in any system whatever, and to this cause, more than any other, do I attribute our present embarrassment." The report also says: "We now have upon the statute books Acts of Assembly, carrying appropriations under which they are now paid, that were enacted more than a century ago, and in recent years this custom of securing appropriations of this character by inserting after the amount of appropriations the word 'annually' has grown apace. These appropriations remain as such until repealed, which is seldom the case, and therefore they are not passed upon by any succeeding Legislatures."

It is evident from my examination of the conditions, from the quotations made, and from the exhibits herein, that the reason for the growth of the deficiencies in the General Funds, as well as in the Special Funds, may be found in the neglect of a true State "budget"—that is to say, the failure to compare

total proposed *expenditure* with total available *revenue*, which is the central feature of a "budget."

Had there been such a comparison in the Legislature of all proposed expenditure with all available revenue annually, the deficiencies would have been clearly exhibited years ago and must have been provided for long before this. One serious failure, therefore, in the finances of the State of Maryland has been the lack of authority to compel all estimates for appropriations, and all other claims against the revenue, to be recorded early in the fiscal year—by November first at the latest. All such demands and estimates should then have been included promptly in a "budget" consisting of these proposed expenditures compared with the total estimated revenues which should have been presented to the Legislature at the beginning of each session, and the financial action of the Legislature should have been restricted to this "budget" except for extraordinary and unforeseen emergencies.

#### HOW CAN THE DEFICIENCY BE MADE GOOD?

The second question which should be answered is "How can this deficiency of \$1,446,555.81 be made good now?" or "How can the demands included in this deficiency be provided for?"

In answering this question we naturally must look first to the State's assets other than cash. What has the State got—if anything—which could be converted into cash and used to pay these outstanding obligations?

#### ASSETS OTHER THAN CASH.

There are on the Treasury books various classes of assets, such as "moneys due to funds," which have not yet been collected, some of which are due to the general fund. Moreover, there are other assets, such as the mortgages on the Northern Central Railway, from which \$90,000 of interest is received annually for the State's general fund. This asset is in the nature of a permanent mortgage on the railroad, originally stated as \$1,500,000, bearing interest at 6 per cent. annually.

This productive asset or claim against the railroad might be considered as a means of raising cash to make good the deficiency, but if it were so used the State would lose its present income of \$90,000 per annum and would have to make up this amount annually by increased taxation. Moreover, the Constitution of Maryland prohibits the use of capital funds such as this for current purposes. It could be used only to cancel a corresponding amount of the State debt.

	Nominal Values as Carried on the State's Books.
Mortgage of Susquehanna & Tidewater Company, due January 1, 1884. Interest defaulted since 1879. Went into receiver's hands in 1893.....	\$1,000,000.00
Stocks of Bohemia Bridge Company.....	15,877.00
Chapter 303 of Laws of 1860. No dividends since 1875.	
Chesapeake and Delaware Canal Company.....	\$1,250.00
Last dividend 1877. Comptroller's report 1886 P. XVIII.	
Baltimore and Yorktown Turnpike.....	2,500.00
Last dividend 1880.	

None of these appears to have a present realizable value.

In addition to these unproductive assets there are various receivables on the State's records, as follows:

Due from Collectors of State Taxes.....	\$1,347,093.34
These taxes are all <i>Special-Funds taxes</i> , and therefore not available to offset the General-Funds deficiency. When collected they will merely increase the balances of the Special Funds.	
Due from Incorporated Institutions.....	64,403.77
These are <i>Special-Funds items</i> also and not available for the General Funds.	
Total receivables of Special Funds.....	\$1,411,497.11

*Receivables, General Funds.*

Due from Railroad Companies, etc.....	\$10,051.37
Unpaid taxes on gross receipts from 1905 to 1915.	
Due from Sheriffs.....	8,952.84
Very uncertain value. Covers period from 1864 to 1914.	
Due from Clerks of Courts, Registers of Wills, etc.....	598.25
These items are due from former occupants of these offices.	
Total receivables, General Funds.....	\$19,602.46

As all of these General-Funds receivables are of doubtful value, we have not exhibited them as assets in the schedules which are appended.

#### HOW TO PROVIDE FOR THE DEFICIENCY.

It is evident, therefore, that provisions must be made by the State for the deficiency of \$1,446,555.81 outstanding on October 1, 1915—possibly two millions on September 30, 1916.

It is further evident that to provide this amount of money promptly the State will be obliged to issue bonds, which should be "serial" bonds, in sufficient numbers to make the deficiency good, and it is also evident that the State must provide *annually* hereafter for the redemption of a portion of these bonds each year by raising the necessary revenue from taxes annually.

Not only this, but the State must raise additional revenue annually sufficient to provide for the present yearly deficit in the general fund, which is bound to develop each year hereafter unless general revenues are increased and general appropriations are reduced until the totals are equivalent to each other. Then only will the State be upon a sound financial basis. This will mean a total increase of revenue amounting to seven or eight hundred thousand dollars *annually*.

These annual deficits in the General Funds of the past are very serious matters. It is through them that the stated deficiency of one million four hundred and forty-six thousand dollars on September 30, 1915, has been built up. How to remedy these annual deficits is a matter to be considered, as we have said, in financial "budgets" for the State every two years, covering each year separately.

#### A STATE BUDGET.

A budget may properly be defined as follows:

"A plan for financing a government during a definite period, which is prepared and submitted by a responsible executive to

a representative body whose approval and authorization are necessary before the plan may be executed."—(*Bureau of Municipal Research, N. Y.*)

For the State of Maryland a "budget" should evidently comprise a *plan* submitted by the Executive to the General Assembly. Such a plan to provide for a definite period, two years at present, and to include all financial requirements for that period.

In Maryland, under its present Constitution and laws, the preparation of such a comprehensive "plan" by the Executive and the presentation of it to the General Assembly in time for prompt and sufficient consideration by the latter body and due action thereon must necessarily be extremely difficult, if not wholly impracticable. The laws must be changed and probably a Constitutional amendment must be enacted before a complete and effective State "budget" can come into being.

In the first place, an incoming Governor, unless he has had long official connection with the government previously, will not be sufficiently familiar with the extremely intricate relations of the departments, offices, commissions, boards and bureaus to "plan" intelligently for them. In the next place, it has always been the custom, if not the legal requirement, for the Legislature to act independently of the Governor in relation to appropriations, frequently without definite plan so far as the State as a whole is concerned. This means that relatively large amounts are appropriated annually of which no indication, or no sufficient indication, could be had by the Executive at the beginning of the fiscal period.

If there is to be a "budget" in this State, it must necessarily be preceded by Legislative action authorizing a means for securing complete information upon which an efficient *plan* can be based. Also, which is even more important, the present unsystematic initiation of appropriations in the General Assembly must be eliminated, as well as the passing of such appropriations without sufficient reference to the needs of the State as a whole, or to the available revenue. New legislation



is, therefore, a prime requisite before a true "budget" can be installed in this State.

As the fundamental requirement of a financial budget must be the relationship between total expenditure proposed and total available revenue estimated, it follows that the questions relating to revenue are as important if not even more important than those relating to appropriations and expenditures thereunder.

### THE REVENUE.

#### *The Fiscal Year 1914.*

When we state that in the fiscal year which closed September 30, 1914, one year ago, the amounts appropriated out of general revenue exceeded by more than \$700,000 the amounts of such revenue actually collected, it will be seen that the condition of the Treasury is a serious one. We have made a careful analysis of the appropriation acts in force during that fiscal year and have separated the various classes of special revenues from the general revenues, and have already submitted to you detailed tabulations, which we summarize as follows:

Total receipts during the year ended September 30, 1914, amounted to \$12,600,566.59. This is the money actually received during the year, not including the balance on hand at the beginning of the year. Of this amount there was received from sales of bonds, available only for specific purposes according to Acts of the General Assembly, \$5,306,096.94. Proceeds of sales of bonds are not revenue. They are not available for general purposes of the State. The moneys received in this way must be handled separately and should not be used for general purposes, except possibly for temporary use, in which case provision must be made for repayment of these moneys to the bond funds whenever they are needed, and these repayments must come out of general revenue.

Aside from these proceeds of bonds there were revenue receipts of \$7,294,469.65, of which \$4,656,231.52 were special revenues designated by law for specific purposes only. The difference between these two amounts is \$2,638,238.13, which was the total amount of general revenue available for the fiscal year 1914, whereas the total appropriations, for which no provision was made except from general revenues, amount to \$3,349,717.19, of which \$2,320,275.34 were appropriated by current Acts of the General Assembly and \$1,029,441.85 had been appropriated "annually" by previous General Assemblies.

The excess of appropriations in the year 1914 over available revenues amounts to \$713,625.65, less whatever balances reverted to the Treasury at the end of the year. This amount represents the deficit of revenue of the State during the fiscal year 1914, or the amount by which the State "ran into the hole" during that fiscal period.

#### *The Fiscal Year 1915.*

During the past fiscal year ended September 30, 1915, the total appropriations from General Funds (with reversions to the Treasury deducted) amounted to \$3,285,719.70.

During that year the actually collected revenues were as follows:

From general taxes, licenses and other sources available for any general purpose, \$2,763,912.16. From special taxes, funds, etc., \$4,712,425.00, while \$3,539,160.00 was received as the proceeds of the State Roads Loan of 1914 (Bonds sold).

This is to say, that while the collections available for general purposes were \$2,763,912.16, the appropriations against these collections amounted to \$3,285,719.70 (reversions to the Treasury deducted).

The difference is \$521,807.54, which is the amount of the deficit of the past year (1915).

*The Fiscal Year 1916.*

The revenue to be collected for general purposes during the current year (1916) is estimated at \$2,884,400.00.

For the current fiscal year ending on September 30, 1916, the total appropriations from general revenue, now available by law, amount to \$2,964,824.48. If the incoming General Assembly at its present session should pass as many and as large appropriations applying to the current year as were passed and applied in 1914, so that the deficit for the year 1916 would amount to five hundred thousand dollars or more, there would then be a grand total outstanding deficiency on September 30, 1916, approaching two million dollars, as stated previously.

Unless prompt action is taken by the General Assembly to cut down the general expenditures and to increase the general revenues, this deficit will grow with every succeeding year.

We trust we have made it evident that the time has now come to stop this wildcat financing in the State of Maryland.

WHAT INCREASES IN REVENUES ARE PRACTICABLE.

We are now engaged in tabulating the various classes of general revenues for the past ten years, so that it will be possible for the Legislature to see what classes of revenues have not kept up with the growth of expenditures. We are also tabulating various new sources of revenue and also possible increases in present revenues, all of which we will complete as soon as possible and submit to you.

It is evident, however, that this question of increased revenue is fundamental. There is no other matter so important. It should be studied thoroughly by the ablest members of the General Assembly, and, I am inclined to believe, should be put into the hands of a special commission—an Efficiency and Economy Commission appointed by the Governor, if so desired—which should report in full to the Legislature before the

end of the present session and should submit a bill, or bills, which can be discussed and acted upon at this session.

#### IMPROVED METHODS OF ACCOUNTING.

It would seem almost unnecessary to emphasize the importance of immediately improving the present methods of accounting and of reporting in the Treasury, as well as in other departments of the State. Much may be done at once, even before a budget system is finally decided upon. The immediate necessities are:

*First*—The establishment immediately of a modern system of accounting in the State books, which will separate all non-revenue moneys (bond funds) from revenue collections, and further separate all special revenues from general revenues.

*Second*—This system should comprise a double-entry balance-sheet method of accounting whereby every month there may be taken off from the general ledger a trial balance exhibiting the current assets and the current liabilities of the State as a whole, together with accurate tables of the revenues and of the expenditures under each class of appropriations, so that the responsible officials, the Legislature and the citizens may know continuously what the financial conditions are and take action accordingly.

*Third*—The funds of the State must be grouped in three classes, viz:

a. Those moneys which are the proceeds of sales of bonds and which can only be used for the purpose specified in the enabling act. Such moneys are termed "Bond Funds" or "Loan Funds" and should be classed as "Non-Revenue."

b. Those moneys of a revenue character, but which under the law are collected for and devoted to specific uses. These include the school tax, the highway tax, the sinking and interest fund tax, motor vehicle licenses, the oyster fund, tobacco warehouse fund, etc. These are termed "Special Revenues."

c. Those moneys which must provide for all appropriations other than those from special revenue and from loans. These are usually called "General" or "Current" Revenues.

While the individual items in each of these classes of accounts are now clearly stated on the Treasury ledgers and are accurately kept by its bookkeepers, at no place are the *totals* of each group assembled and exhibited. It became necessary for us, in order to arrive at such totals, to analyze carefully the character of each account on the ledger. Only in this way could there be contrasted the appropriations which were expected to be met out of general revenue with the revenue actually received (Class C).

It will be noted also in our tables that we have arranged the appropriations according to the purpose for which each was made. These purposes are classified according to standardized "functions" of government. These functional classifications have been adopted by the United States Bureau of the Census in its tabulation of the expenditures of all cities and States. This arrangement brings out in significant totals how much was appropriated (or expended) for "Education," for "Protection of Persons and Property," for "Conservation of Natural Resources" (forests, game, fish, oysters, etc.), for "Agriculture," for "Highways," for "Hospitals," etc., and how much for "General Government."

The information conveyed by such an arrangement will be of material value in determining whether there has been economical and efficient administration, as well as the length to which the State's activities may be properly extended. The value of such information in each State increases with the number of years in which it is available. We, therefore, advise that these classifications shall form a part of the system of accounting herein recommended.

The principal feature of the system we advise would be the installation of a new general ledger in which there would be aggregating or "controlling" accounts for each class of reve-

nues, as well as for appropriations, etc., the details of which would be kept in subsidiary detail ledgers. These accounts would be divided into General, Special, Bond, Trust-Funds, etc., each of which group would be self-balancing. The balancing account of the General Fund group would be styled—if a credit balance—"Current Surplus," and if a debit balance, "Current Deficit." Current surplus should represent at the end of the fiscal year "money in the Treasury not otherwise appropriated," while an overdraft, expressed by Current Deficit, would operate as a constant danger signal. The general ledger would contain a section embracing the State Debt and also the Sinking Fund accounts, the balancing account of which would be the "net debt" of the State. In the course of time this ledger would be extended to include accounts of all the State's property, both real and personal, although it would not be advisable to include such accounts until after the time when suitable inventories of the State's properties could be had.

#### OTHER MEASURES.

Other measures may be suggested for more efficient administration. Among them are the following, the importance and value of which are self-evident:

1. Centralizing in the Comptroller's office vouchers for all expenditures of the State's funds; not merely requisitions for advance of cash.
2. Vesting in the Comptroller greater authority to disapprove demands upon the Treasury.
3. Doing away with the practice of carrying forward from year to year unexpended balances of appropriations for current expenses.
4. Bringing into the books of the Comptroller controlling accounts of the revenues and expenditures of all boards and commissions which operate on a fee basis or otherwise.

In other words, to make the Comptroller's office the general repository of information concerning the State's financial

transactions. Under such conditions the annual report of the Comptroller, with statements and exhibits arranged in the most approved form, would constitute a document of great value to which reference would constantly be made by those seeking information. The present form of report is substantially the same as that inaugurated at the establishment of the office in 1851. It should be remodeled and improved so as to conform to modern requirements.

#### TABULATIONS.

We have deposited in the office of the Comptroller a series of large tabulations relating to the fiscal year 1914. These tables comprise all sources of revenue and all appropriations for expenditure. They have been classified in great detail and are in accord with the standard arrangement by functions of State government which has been provided by the United States Census Bureau for all States of the Union. We have also prepared a complete series of tables covering the old balances, the appropriations, the expenditures and the new balances for two past years, 1913-14 and 1914-15, as well as the current year 1915-16, together with a column for the estimates relating to 1916-17, for which the Legislature will need a budget at this session.

#### RECAPITULATION.

In conclusion, I recapitulate the important items of this report:

*First*—The deficiency of cash to meet obligations September 30, 1915, \$1,446,555.81.

*Second*—The estimated deficiency at the end of the current year, viz: September 30, 1916, \$2,000,000, provided the Legislature should pass additional appropriations applicable to the current year in as large an amount as was done by the last Legislature applicable to the year 1914.

*Third*—The necessity for an issue of serial bonds—say, a maximum \$2,000,000 running ten years; \$200,000 redeemable each year to provide for the deficiency which, if the above proviso be correct, will be facing the State on September 30, 1916.

*Fourth*—The immediate reduction of appropriations; the repealing of continuing appropriations; the careful separation of special appropriations from general appropriations, and a thorough study of the former.

*Fifth*—The necessity of immediate provision for additional general revenue, either by means of new taxes, increases of present taxes, or by a general State tax levied on the counties and cities, if lawful and practicable.

*Sixth*—The immediate installation of budgetary procedure for the State—a "State Budget."

*Seventh*—The immediate installation of improved accounting and reporting methods for the State, particularly in the Treasury department.

*Eighth*—Appended hereto will be found Exhibit II, giving a summary of the receipts of the past year in the three divisions—"General," "Special," and "Loan." Also the appropriations and the expenditures thereunder for the past year, classified in accordance with the new, uniform, functional classification for all States of the Union as developed recently by the United States Census.\*

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We are glad to be able to say frankly that every assistance has been freely and courteously given to us by Mr. Harry J. Hopkins and the officers and clerks in the Treasury and in other departments during the whole time of our examination.

Very respectfully,

HARVEY S. CHASE.

*Certified Public Accountant.*

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\* See Comptroller's Report for 1915.



## EXHIBIT II.\*

## THE INCOME AND THE OUTGO OF THE TREASURY OF THE STATE OF MARYLAND DURING THE FISCAL YEAR ENDED SEPTEMBER 30, 1915.

## RECEIPTS.

Receipts available for general purposes.....	\$2,763,912.16
Receipts available only for special funds.....	4,712,425.20
Receipts available only for loan funds.....	3,539,160.00
Total .....	<u>\$11,015,497.36</u>

## DISBURSEMENTS.

Disbursements for general purposes.....	\$2,539,495.68
Disbursements from special funds.....	4,728,224.21
Disbursements from loan funds.....	3,996,031.20
Total .....	<u>\$11,263,751.09</u>

## SUMMARY.

Total Receipts.....	\$11,015,497.36
Total Disbursements.....	<u>11,263,751.09</u>
Excess of Disbursements (Reduction of Cash Balance).....	\$248,253.73
Cash Balance at beginning, "Treasury proper".....	<u>1,076,962.19</u>
Cash Balance at end, "Treasury proper".....	\$828,708.46
Add Cash Balances in Sinking and other funds.....	<u>774,576.85</u>
Total Cash Balances September 30, 1915.....	<u>\$1,603,285.31</u>

\*Followed by Exhibit II-A, Receipts in detail, and by II-B, Appropriations and Disbursements in detail. These two exhibits may be found in the State Comptroller's report for the fiscal year 1915, under the titles "Statement A" and "Statement B."